DEPARTMENT OF VETERANS AFFAIRS
DISABILITY INSURANCE PROGRAM

NOVEMBER 1973

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December 7, 1973

The Honorable President of the Senate
The Honorable Speaker of the Assembly
The Honorable Members of the Senate and the
Assembly of the Legislature of California

Members:

Transmitted herewith is a report on a review of Disability Insurance Program of the Department of Veterans Affairs. The review was made to determine "if the Department of Veterans Affairs was justified in increasing the premium at the same time it decreased the length of insurance coverage".

Effective November 1, 1973, the department increased the disability insurance premium rate from 2.5 percent to 3.25 percent of covered monthly installments. On a $100 monthly installment, the increase amounts to 75 cents. The upper age limit for disability coverage was also lowered from age 65 to 62. These two changes were justified on the basis of a 1972 actuarial study of the Disability Insurance Program which projected a $54 million deficit by the year 2002 unless the changes were made.

According to the actuarial study, the principal cause for the predicted deficit is attributable to a rapidly increasing rate of disablement among current Cal-Vet contract holders. One of the reasons for the high rate of disablement is a department decision in 1964 to remove health insurability requirements for Cal-Vet disability coverage. Acting on advice of the actuaries, the department reinstated the evidence of health insurability requirement on July 1, 1972 for new purchasers.

By charging a flat rate of 3.25 percent of the monthly installment payment on both existing and new business, younger veterans coming into the plan will be paying approximately 57 percent more for disability insurance than would be required if the projected deficit on existing business did not exist.

Respectfully submitted,

Vincent Thomas

VINCENT THOMAS, Chairman
Joint Legislative Audit Committee

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INTRODUCTION

In 1973, the Department of Veterans Affairs increased the monthly disability insurance premiums on Cal-Vet home and farm loans and lowered the maximum age for coverage. Premiums were increased from 2.5 percent to 3.25 percent of monthly mortgage installments. The upper age for coverage was reduced from 65 to 62. Both changes were to take place July 1, 1973, but were delayed until November 1, 1973, pending approval by the Cost of Living Council.

In response to a legislative request, we have reviewed the insurance program of the Department of Veterans Affairs to determine "if the Department of Veterans Affairs was justified in increasing the premiums at the same time it decreased the length of insurance coverage".

SUMMARY OF FINDINGS

1. INCREASED PREMIUMS AND REDUCED COVERAGE WERE JUSTIFIED BASED ON A 1972 ACTUARIAL STUDY OF THE DISABILITY INSURANCE PROGRAM WHICH PROJECTED A $54 MILLION DEFICIT BY THE YEAR 2002.

2. THE PREMIUM INCREASE WILL REQUIRE YOUNGER VETERANS CURRENTLY ENTERING THE PROGRAM TO ASSUME MOST OF THE BURDEN OF ELIMINATING THE PROJECTED DEFICIT ATTRIBUTABLE TO THE EXISTING POLICY HOLDERS.

BACKGROUND

The Home Protection Plan for Cal-Vets began in 1938 when the California Veterans Board and two California insurance companies, California Western States Life and Occidental Life, signed an agreement to provide life insurance to Cal-Vet farm and home buyers. The terms of the life insurance agreement provided that upon a borrower's death, the policy would pay off the balance of the loan.

In 1955, disability insurance was added to the program. Under this aspect of the insurance program, the policy pays the veteran's loan payments to the board during the time of his total disability.

Insurance coverage under both the life and disability programs of the Cal-Vet Home Protection Plan is, in effect, a plan of self-insurance. The insurance companies administer the plans, but the final responsibility and decision as to the adequacy of premiums is up to the department.

The funds required to pay both types of benefits come from an accumulation of premium payments collected from Cal-Vet borrowers. Like private insurance programs, funds used to pay future benefits are set aside in a reserve fund after current benefits and administrative charges are deducted from the total amount of insurance premiums paid by members. This reserve fund is invested and its earnings are added to the fund.

The insurance companies operating the Cal-Vet program provide all the required administrative services for the program and are reimbursed for their costs. These administrative services include underwriting of policies, claims adjustment and administration, actuarial studies for determining reserve adequacy and setting premium rates, and the investment of funds accumulated in the reserve accounts.

The administrative cost, excluding premium taxes, was $286,000 in 1972 for both the disability and life insurance programs. The monthly administration charge for disability insurance coverage is 0.0333 percent of covered monthly installment payments.

The following major changes have been made to the Home Protection Plan since its inception with regard to disability benefits.

- In 1955, the disability benefit was added. This benefit, which originally paid $50 per month, now pays the entire amount of the veteran's loan payment to the board in case he becomes totally disabled.

- In 1964, health restrictions for securing disability insurance were discontinued.

- In 1972, evidence of health insurability was once more restored for the disability program.

In addition to the benefit changes, premium changes have been necessary. The premium changes are usually required when benefits are increased or actuarial projections indicate that an increase is necessary to maintain the reserve at a required level.

The following tabulation reflects the changes in disability premiums since 1955.

	Premium Amount
1955-1964	$ .80 per month
1964-1968	$1.40 per month
1968-1972	$2.80 per month
1972-73	2.5% of monthly installment payment
1973	3.25% of monthly installment payment

Because there is no express grant of statutory authority for the department to provide for a policy of life and disability insurance for veterans purchasing property under the Cal-Vet program, we requested an opinion from the Legislative Counsel of California as to whether the Department of Veterans Affairs had the authority, expressed or implied, to provide this insurance coverage. In his reply, the Legislative Counsel expressed the following opinion:

> "The Department of Veterans Affairs does have the implied authority to provide for a life and disability insurance policy for veterans purchasing property under the Veterans' Farm and Home Purchase Act of 1943."

FINDINGS

INCREASED PREMIUMS AND REDUCED INSURANCE COVERAGE WERE JUSTIFIED BASED ON A 1972 ACTUARIAL STUDY OF THE DISABILITY INSURANCE PROGRAM WHICH PROJECTED A $54 MILLION DEFICIT BY THE YEAR 2002.

A 1972 actuarial forecast performed by actuaries at California-Western Life Insurance Company (Cal-West) projects a long-term deficit in the disability reserve. The forecast shows that under the factors and assumptions used in the study, the disability reserve would have a deficit balance of $54.2 million by July 1, 2002 unless changes are made to the premium rate and/or coverage.

As of June 30, 1973, a negative reserve balance of $761,000 existed in the disability insurance portion of the Home Protection Plan. Consequently, the payment of benefits for disability recipients are being made, in part, from reserves established for the life insurance phase of the Home Protection Plan.

Results of 1972 Actuarial Study by Cal-West

Presented in Table I below is a summary of the results of the 1972 actuarial study. The summary shows the expected impact on the disability reserve if the maximum age covered were changed from 65 to 62 effective July 1, 1972.

Table I

Maximum Age Covered	Disability Reserve As of 7/1/2002 At 2.5% Premium Rate	Premium Rate Needed To Make Disability Reserve Zero
65		
New Business	$ 2,267,607	2.35%
Existing Business	-56,542,983	4.24
Combined	$-54,275,376	3.64%
62		
New Business	$ 6,259,429	2.07%
Existing Businesss	-33,706,968	3.64
Combined	$-27,447,539	3.12% *

* Effective November 1, 1973 a 3.25 percent premium rate was adopted.

Department Decides To
Increase Premiums and Remove
Veterans Over 62 from Coverage

As a result of the 1972 actuarial forecast, and in accordance with a recommendation of the Insurance Office of the Department of General Services, the Department of Veterans Affairs proposed two changes to the disability insurance program effective July 1, 1973. (Implementation of these changes was delayed until approval was received from the Cost of Living Council in October, 1973.) The two changes effective November 1, 1973 are:

1. Premium Rate - The premium rate for disability insurance is increased from 2.5 percent to 3.25 percent of covered monthly installments for all existing and future new contract holders.

2. <u>Contract Change</u> - The upper age limit for disability coverage is lowered from age 65 to 62 for all existing and new contract holders who are not currently disabled.

THE PREMIUM INCREASE WILL REQUIRE YOUNGER VETERANS CURRENTLY ENTERING THE PROGRAM TO ASSUME MOST OF THE BURDEN OF ELIMINATING THE PROJECTED DEFICIT ATTRIBUTABLE TO THE EXISTING POLICY HOLDERS.

The premium increase for 1973 is the second premium change in the disability program in recent years. On July 1, 1972, the premium amount for disability coverage was changed from $2.80 per month per contract holder to a premium rate of 2.5 percent of the veteran's monthly installment payment. The 1972 change in the method of premium payment and the 1973 increase in premium rate have resulted in the younger veteran coming into the program assuming most of the burden of eliminating the projected deficit that has been brought forward by the existing contract holders.

From the inception of the disability program in 1955 until the 1972 premium change, the program had maintained a flat premium rate for all insured veterans regardless of their age or the amount of their installment payment. The 1972 premium change introduced into the program a variable method of premium payment whereby the amount paid by the purchaser is dependent upon the amount of his monthly installment payment.

Table II which follows shows that, on the average, each existing contract holder will be paying a monthly premium that is 43 cents less than the actuarial study showed to be his requirement. Conversely, each future purchaser will be paying, on the average, a monthly premium that is $2.26 more than the actuarial study indicated to be his requirement.

Table II

Effect of 1973 Premium and Coverage Changes
On Existing and New Business

	Existing Business	New Business
Average Monthly Installment Payment 7/1/73	$109.00 (1)	$191.00 (1)
Premium Amount on Average Monthly Installment Payment (Payment X 3.25% Premium Rate)	$ 3.54	$ 6.21
Premium Needed by Each Group to Meet Actuarial Requirement (Maximum Age 62)		
Existing (Payment X 3.64% premium rate) (2)	3.97	
New (Payment X 2.07% premium rate) (2)		3.95
Monthly Premium Over or (Under) Payment Based on Actuarial Requirements	$ (.43)	$ 2.26

(1) Information supplied by the Department of Veterans Affairs.
(2) See Table I on page 6.

On a percentage basis, the younger veterans (new business) coming into the plan will be paying approximately 57 percent more for disability insurance than would be required if the projected deficit did not exist. The existing group of veterans under the program will be paying about 11 percent less than the premium requirement developed by the actuarial study.

FACTORS CONTRIBUTING TO THE PREDICTED DISABILITY RESERVE DEFICIT

The principal cause for the predicted deficit reserve balance that has produced a need for increased premiums is attributable to a rapidly increasing rate of disablement among current Cal-Vet contract holders.

The disablement rate has increased most noticeably during the past two years although there has been a trend of increasing disablements since 1964.

Table III, developed from information shown in Cal-West's 1972 actuarial study, displays the actual disability experience of Cal-Vet contract holders to a standard base rate of expected disablements.

Table III

Cal-Vet
Rates of Disablement
Per 1,000 Enrollees

From	To	Rate Of Disablement Actual	Standard Base Rate Of Disablement Expected
7/1/64	7/1/65	6.529	5.890
7/1/65	7/1/66	6.932	6.133
7/1/66	7/1/67	7.214	6.374
7/1/67	7/1/68	8.378	6.652
7/1/68	7/1/69	9.127	6.897
7/1/69	7/1/70	9.592	7.204
7/1/70	7/1/71	11.671	7.470
7/1/71	7/1/72	13.721	7.762

One of the reasons that could be attributed to the high rate of disablement among Cal-Vets is a department decision made in 1964 that removed health restrictions for securing disability coverage.

In 1964, the insurance agreement between Cal-West, Occidental Life, and the department was amended to read:

> "...on and after January 1, 1964, evidence of good health shall not be required as a condition precedent to issuance of the Supplemental Agreement setting forth a benefit in the event of total permanent disability."

This meant that all new contract holders under age 65 and gainfully employed on a full-time basis, qualified for disability insurance without regard to any impairment of insurability that may have existed. Also in 1964, the insurance companies agreed to offer disability coverage at the same rate to all previously declined contract holders regardless of the degree of their impairment so long as they were gainfully employed and under age 65. At the time of this open enrollment, the department estimates that approximately 2,500 veterans who had been previously declined coverage for health reasons were admitted under the program.

The entrance into the program by veterans possessing pre-existing disabilities produces a probability of disablement rates in excess of normal.

The adverse effects attendant with the insurers no longer having the right of refusing poor health risks began to worsen in 1971. In November 1971, Cal-West actuaries reported on the condition of the disability program as follows:

> "Some action must be taken to stop the deterioration of the disability experience if possible. Perhaps this situation could be stabilized by reinstituting evidence of insurability for disability coverage."

Acting upon this report, the department on July 1, 1972 reinstated the evidence of health insurability for new purchasers. The full effects of the decision to reinstate evidence of health insurability will not be realized until some future date because pre-1972 borrowers were not subject to the health requirements. In any event, the reinstated health requirement provisions were considered by the actuary in his study.

Harvey M. Rose

Harvey M. Rose
Auditor General

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